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THE TAX REVIEW

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TAX ON UNDISTRIBUTED INCOME OF CLOSELY-HELD COMPANIES

ADVANTAGES AND DISADVANTAGES

By George P. Keeping, C.A.

THIS PAPER IS DEVOTED TO A CONSIDERATION of some of the advantages and disadvantages to the taxpayer of the new Part IA of the *Income Tax Act* and thereby assist him to form an opinion as to whether he will find its provisions sufficiently attractive to him to cause him to elect to pay the 15% tax and, if so, at what point in time will he consider it most advantageous to so elect.

Election to Pay Tax on Pre-1950 Undistributed Income

We are all aware that substantial surpluses have been built up by closely held corporations and even by those corporations which availed themselves of Part XVIII of the *Income War Tax Act* and that the "Sword of Damocles" has been hanging over the head of many a principal shareholder. He can walk now from under that sword a free man — for a ransom of 15%. Will that ransom lure him? What are his alternatives and do they provide him with a cheaper form of salvation?

He can stay under the sword hoping that it will never fall. So far as I can see his only hope in these circumstances is that he will never die and, despite the rapid strides being made in medical science, I submit that that hope is a forlorn one.

He can stay where he is and be prepared to let the sword fall. However, the rates of income tax are, at present, and seem more than likely to remain in the foreseeable future, so high that under normal circumstances the cost of withdrawing at any one time, without prior election, only a small portion of the undistributed income would be considerably higher than the 15% ransom. This fact will be readily appreciated when it is realized that the present 15% bracket in personal rates applies only to taxable income that does not exceed $1,000. Consequently, to be prepared to let the sword fall, he must be certain that under no circumstances and at no time, including his death, will it be necessary to draw upon the undistributed income of the company to any significant extent.

He can stay where he is hoping that the ransom will be reduced; that is to say, that the government will, at some future date, see fit to offer him a better deal. In other words, he can emulate the man who turned down Part XVIII of the IWTA and has now been reward-

A paper read to the 48th annual meeting of the D.A.C.A. Charlottetown, August, 1950

ed with Part IA. This, to my mind, is also a forlorn hope. The new legislation differs fundamentally from Part XVIII in that it makes provision for future surpluses which Part XVIII did not. Part IA is, therefore, an attempt to find a permanent solution for the problem of closely held corporations. Although it is just conceivable that the rate of tax applicable to post-1949 retained earnings may at some future time be reduced, due to radical changes in the rates of personal tax, I cannot imagine any reduction ever being made in the rate of tax applicable to the pre-1950 undistributed income.

He can hope to find someone else to take his place under the sword; that is to say, dispose of his interests in the company. If he disposes of his shares to an individual, that individual will be in the same position as himself and it is safe to assume that our shareholder will pay at least the equivalent of the 15% tax by way of reduction in the selling price of the shares. If he sells his shares to another company, his company will then become a controlled corporation within the meaning of the Act. The surplus at acquisition, as a result, will be frozen in the hands of the subsidiary until such time as the 15% tax is paid, unless the parent company is prepared to pay tax at the corporation rate on dividends paid out of the surplus at acquisition. In these circumstances too, I think it safe to assume that the ultimate liability to the 15% tax will be taken into account in determining the selling price of the shares.

To sum up, I cannot see that the alternatives provide a cheaper form of salvation and I believe that, in general, closely held corporations with a surplus problem will find the provisions of Part IA sufficiently attractive to cause them to elect to pay the 15% tax on their pre-1950 undistributed income.

Let us now consider the factors affecting the choice of the point in time at which a corporation will find it most advantageous to elect and to pay tax on its pre-1950 undistributed income. As I understand the law, the election accompanied by the payment of the tax may be made at any time. For practical purposes, that means at any time from now until such time as it is necessary to withdraw from the company a substantial part of the undistributed income, say for the purpose of paying succession duties on the estate of a principal shareholder. On the grounds that a bird in the hand is worth two in the bush, in other words, we know the law now and it is possible that it may be changed later to our disadvantage, a good case can be built up for making the election immediately and, in addition, making a tax free distribution to the shareholders by way of reduction of capital or redemption of shares, thus insuring that the shareholders are in the clear at least so far as the pre-1950 undistributed income is concerned. Lack of cash resources need not constitute a barrier to this procedure as the funds distributed presumably may be returned immediately to the company by way of loan.

On the other hand, if one can use money profitably, why pay it to the government earlier than one has to? It seems to me that the election may be even deferred until immediately after the death of a principal shareholder. To delay action as late as this, however, might result in higher succession duties in that the 15% tax would not be a liability of the company at the date of death and would, therefore, probably result in a higher valuation being placed for succession duty purposes upon the shares of the company.

The choice of the time at which to elect to pay tax on pre-1950 undistributed income is, of course, also affected by

any decision made to elect to pay tax on post-1949 undistributed income because the latter election cannot be made until the former has been made.

On balance, my thinking at the present time tends towards advocating election at an early date, provided funds can be made available with which to pay the tax.

Election to Pay Tax on Post-1949 Undistributed Income

I will consider briefly now the question of election to pay tax on post-1949 undistributed income. It seems to me that the factors affecting the decision to elect to pay this tax (the undistributed income on which the tax can be paid being limited, of course, to the amounts distributed by way of dividend in 1950 and subsequent years) are much the same as those affecting the decision to elect to pay tax on the pre-1950 undistributed income. Consequently, I am of the opinion that closely held corporations will also find this provision of the Act attractive and that as a result the payment of dividends may be stimulated.

Consideration of the point or points in time, however, at which this election or these elections may be made is interesting. As with pre-1950 undistributed income, election may be made at any time. For example, provided tax on the pre-1950 undistributed income has been paid, election may be made in 1951 and annually thereafter. If this were done and tax paid on retained earnings to the extent of dividends paid, the company would at all times be in the position of having the maximum portion of its undistributed income tax paid. It follows, therefore, that if in each year a company distributed one-half of its earnings by way of dividend then at all times the whole of its undistributed income would to all intents and purposes be tax paid undistributed income. That is one end of the scale. At the other end of the scale is the company which defers taking any action until such time as it is necessary in order to withdraw from the company undistributed income in excess of the pre-1950 undistributed income.

What are the *pros* and *cons* of these two widely divergent policies? It seems to me that the principal argument for making the election annually is that thereby the shareholder is consolidating his position as he goes along and can be said to be taking out insurance against a change of heart on the part of the Government as regards both the cost of the ransom and the very right to extricate himself by payment of a ransom. A premium, of course, must be paid for this insurance and that premium, as I see it, consists principally of the return which the company could have been earning upon the money disbursed in tax.

Against annual election is the spectre of depression years and the possibility of incurring losses. In these circumstances a company that has elected annually might find itself in the peculiar position of having paid tax on an amount in excess of its total undistributed income as defined by the Act.

To leave election to the last possible moment before it is necessary to draw upon post-1949 undistributed income entails taking the risk that the law may be changed, but gives the company the use of the tax money for as long a period as possible. On the other hand, as pointed out in connection with pre-1950 undistributed income, if election is made after the death of a shareholder, there is danger of incurring some loss of benefit by reason of increased succession duties.

Perhaps, a middle course will prove to be most popular. Undoubtedly, payment of tax on the pre-1950 undistributed income, in a great many cases, will remove the potential danger for a num-

ber of years to come, and only when post-1949 surplus has reached dangerous proportions will companies consider it desirable to make the election.

Extension of Dividend Credit

In conclusion, I must say that Part IA appeals to me as a constructive piece of legislation and I believe that it stands a fair chance of providing a permanent solution to the problem which, for many years, has faced a number of taxpayers and which has been recognized by the Government as a detriment to the Canadian economy.

MECHANICS AND OPERATION

By James Stewart Innes, C.A.

THE NEW LEGISLATION IS OF A COMPLICATED nature and in order to acquire the desired results great care should be taken by any company which wishes to take advantage of the new legislation.

Relevant Sections of the Income Tax Act

Section 95A provides the necessary statutory authority for private companies to elect to pay the 15% tax. It also contains the definition of "private company" and "shareholder" and indicates how the tax is to be paid, etc.

It permits a company to make an election (1) with respect to its undistributed income at the end of the 1949 taxation year and then again (2) to elect in respect of accumulations in subsequent taxation periods.

In addition to s. 95A careful study should be given to s. 73 dealing with undistributed income on hand. Subsec. (4) is of particular significance in that it describes the taxable portion of a "deemed to be dividend".

Section 73A defines "undistributed income on hand" and "tax paid undistributed income".

Section 27 (1A) to (1F) was added to prevent a company which in future obtains control over another company having undistributed income on hand from deducting from income dividends received from the controlled company in excess of the income earned by the controlled company since control was taken, unless the controlled company has elected to pay the 15% tax on such undistributed income under s. 95A. The amendments are applicable where the receiving corporation acquired control of the payor corporation after May 10, 1950.

Section 8(1)(c) dealing with the appropriation of property to shareholders should be studied along with the above noted sections before arriving at any solution on how tax paid undistributed income may be diverted tax free into the hands of a company's shareholders.

Elections

1. *With Respect to 1949 Surplus:*

An election by a private company under s. 95A(1) shall be made by filing with the Minister the following documents *in duplicate*:

(1) The form P.C. 2 prescribed by the Minister;

(2) Form P.C. 2 calls for schedules showing the corporation's computation of undistributed income and tax-paid undistributed income;

(3) A certified copy of the resolution of the directors of the corporation authorizing the election to be made;

(4) Where the corporation has more than

75 shareholders an explanation of how the corporation qualifies as a private company.

A company must elect to pay the tax on the *total* amount of its undistributed income on hand at the end of the 1949 taxation period minus its tax paid undistributed income as of that time and may not make an election based on some fractional amount. The tax is payable in full with the election.

While there is no time limit set in respect of an election to pay tax on the 1949 undistributed income it may be advisable to take prompt action to consolidate the shareholder's position in this respect.

2. *With Respect to the post-1949 Periods:*

If the tax has been paid on the 1949 undistributed income or if the tax-paid portion of this amount exceeds the portion on which tax has not been paid the taxpayer may make further elections and pay tax on accumulations in the 1950 and subsequent taxation years. In such cases, though, the taxpayer may only elect to pay tax on an amount not exceeding the aggregate dividends it has declared and paid out beginning with the 1950 taxation year and ending with the last complete taxation year before the election. Such aggregate dividends exclude dividends paid subsequent to the 1949 taxation period which are excluded from the income of the recipient by virtue of s. 129(2).[1] They also exclude the aggregate of the amounts upon which the company has already filed an election and paid tax in respect of 1950 and subsequent taxation years.

The requirements for filing an election in respect of the post-1949 period are similar to the requirements outlined above but the form prescribed by the Minister is not yet available.

Example

The X Co. had undistributed income at July 31, 1949 of $300,000. Of this amount $100,000 represented tax-paid undistributed income which existed due to action taken by X under Part XVIII of the IWTA. In the year ending July 31, 1950 the X Co. had income after payment of tax amounting to $180,000 and paid out dividends amounting to $130,000. The company had income after payment of tax in the 1949 taxation year amounting to only $20,000.

If the X Co. wishes to take advantage of s. 95A it must make an election and pay tax on $200,000. It may then make a further election in respect of the 1950 taxation year and pay tax on $30,000 ($130,000 *less* tax free dividend of $100,000 paid out under s. 129(2)[1] of the ITA).

After the above elections the company's surplus stands as shown on p. 138.

Capitalization of Tax-Paid Undistributed Income

It is important to realize that tax-paid undistributed income which has resulted from an election or elections made under s. 95A of the ITA may not be distributed

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[1]Section 129(2) is as follows:

Private Company Dividends. — There shall not be included in computing the income of a taxpayer for a taxation year amounts received by the taxpayer in the year as dividends that would, if the *Income War Tax Act* were applicable to the taxation year, be exempt from taxation under that Act by virtue of section 95 thereof as exempt dividends from a private company and a dividend that would not be taxable under subsection (2) of section 9B of the *Income War Tax Act* by virtue of subsection (6) of that section, if that Act were applicable, is not taxable under Part II of this Act.

Undistributed income as at July 31, 1949			$300,000
Add: Undistributed income earned in year ending July 31, 1950		$180,000	
Deduct:			
Dividend paid in 1950	$130,000		
15% tax paid on $200,000	30,000		
15% tax paid on $30,000	4,500	164,500	15,500
Undistributed income on hand			$315,500

The tax-paid portion of undistributed income is now as follows:

Tax-paid undistributed income as at July 31, 1949	$100,000
Add: Increase due to election to pay tax on 1949 balance ($200,000 — $30,000 tax)	170,000
Increase due to election to pay tax on 1950 portion ($30,000 — $4,500 tax)	25,500
	$295,500
Deduct: Tax-free dividend paid out in 1950	100,000
Tax-paid undistributed income	$195,500

Note:

If X Company had paid out a dividend in 1950 in the amount of $190,000 it would have been in a position to elect to pay tax on $90,000 instead of $30,000. It will be possible for the Company to pay tax on an additional $60,000 in some subsequent election provided an additional $60,000 has been paid out by the Company by way of dividends.

as an *ordinary dividend* to shareholders and be tax free in their hands.

If the company wishes to accomplish this it should take preliminary steps to capitalize the required amount first. In order to avoid the possibility of some portion of the amount being subjected to tax on final distribution it appears to be preferable to pay a stock dividend to the shareholders by means of preferred shares. If such a step is taken it would seem probable that no portion of such shares would be taxable on their eventual redemption.

It may be that a corporation may not be in a position to actually redeem such preferred shares but if it was considered desirable to place such shares beyond any further doubt as to their taxability it might wish to issue notes payable to such preferred shareholders on any such redemption.

Any step whereby tax-paid undistributed income is capitalized may require a preliminary step by the corporation concerned to make application for supplementary letters patent if the present capital structure is not adaptable. At such a time possible future requirements of the Company should be taken into consideration.

In the case of parent-subsidiary relationships proper steps should be taken to deal with the 1949 undistributed income of the subsidiary company first. If the subsidiary's 1949 undistributed income is taken up as a tax-free dividend by the parent company first it becomes

part of the parent company's post-1949 undistributed income and it would be necessary to pay current dividends out of such income before any election could be made in respect of this amount.

Computation

In computing the amount on which the election is to be made it should be appreciated that this amount may vary considerably from the net profits as shown by the financial statements of the corporation or from taxable income as determined. Capital profits should be excluded as these are not included in the definition of undistributed income. Capital losses are deductible to the extent that they exceed capital profits. Donations may have been limited to 5% of the income by the Department in determining taxable income but the total of donations made will be deducted in arriving at undistributed income. Dividends from other Canadian companies may have been eliminated in arriving at taxable income, but they are included in arriving at the figure of undistributed income.

Advantages and Disadvantages

The main advantage appears to be the possible tax saving that may be enjoyed but it is often difficult to determine exactly what this saving may be.

In order to make any estimate of this it is necessary to estimate the taxes payable by the corporation, if an election is made, and separately to estimate the taxes payable by the shareholders if a distribution was made to them and the company has not made an election. Other estimates must be considered such as the expenses incident to making an election and the interest element.

In calculating the possible tax saving it should be remembered that where payments are made to an individual shareholder (resident in Canada) as regular dividends the shareholder is entitled to a deduction from his tax payable of up to 10% of the dividends so received. This recent tendency on the part of the Canadian Government to grant some relief from double taxation might be considered as an argument against making an election although there would not appear to be any immediate likelihood of further reductions along these lines.

Where an election is made and the tax is paid and the corporation subsequently suffers severe losses a tax loss could result if such losses were not recouped in subsequent periods.

The payment of the 15% tax on making an election may be an immediate disadvantage to many corporations if their current working capital position is not adequate.

Conclusion

In spite of the complexity of the legislation and the necessity of alterations to the capital structure of corporations and the expense involved it is probable that many corporations will feel that it is to the advantage of their shareholders to take immediate action and investigate this legislation. Official decisions could not be made until the particular problems and features of each corporation had been carefully reviewed from all possible angles.

RECENT TAX CASES

Dobell v. Minister of National Revenue

(Exchequer Court of Canada, Angers J., June 6, 1950)

Income Tax — Gift Tax — Donation in ante-nuptial agreement — Quebec Civil Code — Subsequent handing over of property — Whether made to evade taxation — Whether husband chargeable on income from property — Whether a gift exigible to gift tax — IWTA s. 32(2), 88

By an ante-nuptial agreement made in England in 1911 Dobell gave to his intended wife a sum of $10,000 secured by a mortgage and hypothec on certain immovable property. The parties married and their matrimonial domicile at all times was in Quebec, where the ante-nuptial agreement was deposited and registered. In 1943 Dobell, in discharge of the above obligation, handed over to his wife interest-bearing bonds of a par value of $9,000. (He had previously paid her $1,000, which was not in issue in the appeal.) The wife, who was separate as to property, thereupon discharged the mortgage. Dobell was assessed to income tax for 1943 under IWTA s. 32(2) on the interest upon the said bonds, and was assessed to gift tax under IWTA s. 88 on the value of the said bonds. He appealed.

Held, the appeal should be allowed on both points.

The object of s. 32(2) is to tax in the hands of a transferor income from property which has been transferred for the purpose of evading taxation; and as the grant made by Dobell to his future wife was made in fulfilment of an ante-nuptial obligation antedating the *Income War Tax Act* it was not made for the purpose of evading taxation. *Molson* v. *MNR* [1937] Ex. C.R. 55 (Angers J.), followed: [1938] S.C.R. 213 (Can. S.C.), considered; *Fasken's Executors* v. *MNR* [1948] Ex. C.R. 580, not followed: *MNR* v. *Nat'l Trust Co.* [1946] Ex. C.R. 650, *Royal Trust Co.* v. *MNR* [1948] Ex. C.R. 34; *Connell* v. *MNR* [1946] Ex. C.R. 562, considered.

Appeal allowed

Ross v. Minister of National Revenue

(Exchequer Court of Canada, Cameron J., July 7, 1950)

Income Tax — Grant of oil and gas rights in land — Payment of fixed sum out of percentage of production — Whether a royalty or like a royalty — Whether payment dependent on production or use of property — IWTA s. 3(1)(f)

Income Tax — Depletion allowance — Royalty dependent on production of oil well — Amount of allowance — Discretion of Minister — IWTA s. 5(1)(a)

Income Tax — Penalty for late filing — Whether executor subject to general or specific penalty — IWTA s. 33(1), 36, 77(1)(c), 77(2)

In 1938 an Alberta land-owner leased to Royalite Oil Co. for an extendable term certain hydro-carbons (oil and gas) in her land with the right to explore and operate the land and remove oil and gas therefrom. Royalite agreed to pay a sum in cash and deliver to the lessor monthly "as royalty and rental" 10% of oil and gas produced or its value; and had an option to purchase the land outright for an additional cash payment plus $60,000 payable out of

10% of oil and gas produced. Royalite exercised the option but the lessor died without having given a transfer of the land, and after her death Royalite, in 1940, concluded the transaction with the lessor's executrix in a different manner: it surrendered its lease and received from the executrix a transfer of all oil and gas in the lands, making her a large cash payment and giving her a registrable incumbrance on the oil and gas to secure payment of a royalty of $60,000 out of 10% of oil and gas produced. It paid this last sum out of production during the years 1944, 1945, and 1946. Executrix, who failed to file a return of income within the time limited by the Act, was assessed to tax for 1944 and 1945 on the amounts so paid her in such years after deduction of a depletion allowance of 25%, and she was also assessed to a penalty of $500 under IWTA s. 77(1)(c) for late filing. It was admitted that at the time of fixing the depletion allowance at 25% the Minister knew that the whole amount of $60,000 payable to the executrix had been paid in three years. The executrix appealed on the ground (1) that the $60,000 was not a royalty within the meaning of IWTA s. 3(1)(f); (2) that if it was a royalty it did not "depend upon the production or use of any property" as required by s. 3(1)(f); (3) that the Minister exercised his discretion under s. 5(1)(a) wrongly in not granting a depletion allowance of 33 1/3%; (4) that the penalty for late filing of a return by an executor could only be imposed under s. 77(2) and the $500 penalty actually imposed was therefore excessive; (5) that appellant had been assessed under s. 11(2) on the basis that there was one trust only whilst in fact there were two.

Held, the appellant failed on the first three points, but succeeded on the last two.

(1) Even assuming (but without deciding) that a royalty must be the subject of a reservation to an owner in a grant or demise and that there was no such reservation here, it suffices under s. 3 (1)(f) that the receipts be *"like"* royalties, i.e., in reference to mines or wells, periodical payments in money or kind depending on production or use of the mine or well, payable for the right to explore, produce and dispose of the oils or minerals yielded. The receipts here fulfilled these requirements and were therefore *"like"* royalties if not royalties in fact. *Spooner* v. *MNR* [1931] S.C.R. 399, [1933] A.C. 684; *I.R.C.* v. *Wesleyan Ass'ce Soc.* [1948] 1 A.E.R. 555 at p. 557; *Mercer* v. *A.-G. Ont.* (1882) 5 S.C.R. 538, applied.

In connexion with this point, the fact that the Royalite Co., in its own income tax returns, treated the entire consideration paid to appellant and her testatrix, including the $60,000 paid out of production, as capital and made no deduction in respect thereof from its own taxable income, was irrelevant and inadmissible in evidence: *B. & M. Readers' Service Ltd.* v. *Anglo Canadian Publishers Ltd.* (C.A.) [1950] O.R. 159 at p. 164, distinguished. Moreover, it does not necessarily follow that a payment which is a capital expenditure by the payor is not a receipt of income by the payee: *Brodie* v. *I.R.C.*, 17 T.C. 432.

(2) The word "production" in its ordinary sense includes the following "to bring forth, to furnish, generate, yield, supply", and in association with the word "royalties" must be taken to cover the production of oil or gas from land, and cannot be restricted to mean only that which is made or grown, i.e., the recurring produce of property: *Hanfstaengl* v. *American Tobacco Co.* [1895] 1 Q.B. 347, per Rigby L.J. at p. 355, referred to.

It was immaterial, in face of the

specific language of s. 3(1)(f), that the payments were limited to a specific sum, viz., $60,000.

(3) The fact that the Minister was aware, at the time of fixing the depletion allowance for 1944 and 1945, that the entire $60,000 had been paid appellant in the course of three years did not enable the Court to hold that the depletion allowance of 25% was not a just and fair one: *Fraser* v. *MNR* [1949] A.C. 24, applied.

(4) While the language of s. 33(1) requiring "every person liable to taxation" to file a return is wide enough to include an executor, the latter is also specifically covered by s. 36, and in view of the fact that separate and specific penalties are provided by the Act by reference to the particular section which requires the filing of a return, it must be held that an executor is subject only to the specific penalty imposed by s. 77 (2) for late filing: see *Craies on Statute Law* (4th ed.) at p. 200.

(5) The Crown admitted that there were two trusts in fact.

As appellant has had substantial success, she is entitled to her costs.

Judgment accordingly

INCOME TAX APPEAL BOARD CASES

(*Graham J. (ad hoc.), Chairman, Fabio Monet Esq., K.C., Assistant Chairman, and W. S. Fisher Esq., K.C.)*

Green v. M.N.R.

Income — Interest on moneys loaned held by borrower to account of lender — Whether interest received by lender — IWTA s. 3(1)

Green, a practising lawyer, was also a director of a finance company with which he had the following arrangement: an account was opened by the company in his name, in which were entered as deposits all sums loaned by him to the company and, as withdrawals, all sums withdrawn by him. In addition an amount for interest calculated at 5% on the balance at the end of each month was entered to his credit. In 1946 he deposited $15,917, withdrew $9,392, and was credited with $1,070. He contended that the interest so credited to his account was not chargeable to him as income on the ground that he did not actually receive it, and cited *Trapp* v. *MNR* [1946] Ex. C.R. 245 (Thorson P.) in support.

Held (F. Monet and W. S. Fisher), since Green had agreed to the inclusion of interest owed him in the amount standing to his credit at the end of each month, the company fulfilled its obligation when it followed that course and Green thereupon *received* the amount of interest so added to his balance. He was at all times free to withdraw any or all of the amount standing to his credit, which he could hardly have done if he had not full ownership of the amount. The interest, therefore, was income within the definition of IWTA s. 3(1).

May 3, 1950 *Appeal dismissed*

Schioler v. M.N.R.

Travelling expenses — Trip to Europe to obtain appointment as agent and new capital — Prohibited from deduction — IWTA s. 6(1)(a)

Schioler, who was in the loan and financing business, and had formerly been general agent for a foreign steamship line, made a trip to Denmark in 1946 to seek an appointment as steamship agent for the same line or any other line and, secondly, to obtain capital for

his business. He sought to deduct one-third of his travelling expenses from his income for that year.

Held (F. Monet and W. S. Fisher), the expenses were properly disallowed under IWTA s. 6(1)(a) as not having been wholly, exclusively and necessarily laid out or expended for the purpose of earning the income. They were not incurred "in the process of earning the income" (see *Dom. Natural Gas Co.* v. *MNR* [1941] S.C.R. 19, per Duff C.J.C.), and were of the nature of a preliminary expense made with a view to obtaining something liable to produce income.

May 3, 1950 *Appeal dismissed*

Weidman Bros. Ltd. v. M.N.R.

Loss by theft — Government bonds held by trading company as cash and for sale to employees — Not held as investment — IWTA s. 6(1)(b)

A wholesale grocery company kept in a vault a large number of Canadian Government Victory Loan bonds, mostly of small denomination, and in spite of an elaborate burglar-proof system a burglary took place without any warning being sounded and a number of the bonds were stolen. The majority of the stolen bonds had come into the company's hands in payment of trade accounts and the balance were being held by the company temporarily for eventual delivery to those of its employees who had subscribed to purchase bonds under a payroll deduction plan instituted by the company to encourage the sale of Victory bonds. The company claimed a deduction from its income of the loss so sustained, amounting to $8835. The Minister disallowed the deduction claimed under IWTA s. 6(1)(b) on the ground that the loss was one of capital.

Held (W. S. Fisher and F. Monet), the company was entitled to deduct the loss so sustained by reason of the burglary. The stolen bonds were not being held by the company as an investment. The burglary took place while the company was carrying on normal routine business activities and running the risk that a burglary might take place. The risk of loss of cash and merchandise is a hazard of business which all companies in business run.

May 17, 1950 *Appeal allowed*

Levine v. M.N.R.

Net worth assessment — Earning from bookmaking business — Gains from private wagers — Onus of proof — Credibility of witnesses

On an appeal against a "net worth" assessment made pursuant to IWTA s. 47 in the amount of $5336 for 1946, appellant testified that his earnings for the year from a bookmaking partnership of which he was a member were about $2000 and that any moneys received by him during the year in excess of that amount were from private wagers and not chargeable to tax. The partnership did not retain any records of its operations because of the unlawful nature of its business, and while witnesses testified to certain successful wagers made by appellant there was nothing to show that he realized a net gain from this activity.

Held (*per tot. cur.*), appellant had not satisfied the onus on him of rebutting by satisfactory evidence the presumption of validity which attaches to an assessment made under s. 47. (See *Dezura* v. *MNR* [1947] C.T.C. 378; *Commercial Hotel Ltd.* v. *MNR* [1948] C.T.C. 7). The Court could not attach a high degree of credit to the evidence of witnesses engaged in illicit activities.

May 22, 1950 *Appeal dismissed*

DeWolf v. M.N.R.

Travelling expenses — Landowner travelling to supervise operation of farm lease — Expenses not deductible — IWTA s. 5(1)(f), 6(1)(f)

DeWolf, who resided in Vancouver, owned considerable farm lands in Saskatchewan, and claimed a deduction from his 1946 income of $332 for travelling expenses (including meals and lodging) incurred by him on a trip from Vancouver to Lucky Lake, Saskatchewan, which he made with a view to finding a proper person to carry on farming operations and also to look into the operation of a farm which he had leased.

Held (*per tot. cur.*), while appellant may have been well advised to make the trip in his own interest the expenses incurred were not deductible under IWTA s. 5(1)(f), which permits the deduction of travelling expenses only where the taxpayer has to travel from place to place in the performance of his duties, e.g., commercial travellers: *Mahaffy* v. *M.N.R.* [1945] C.T.C. 408 (Ex.), [1946] C.T.C. 135 (S.C.C.), followed. The amount expended on meals and lodging, being personal expenses, was expressly prohibited from deduction by IWTA s. 6(1)(f).

May 23, 1950 *Appeal dismissed*

Sebilleau v. M.N.R.

Investment or earned income — Administration of rental property — Whether carrying on business — IWTA s. 2(1)(m) and (n)

Appellant appealed from his assessment to surtax of 4% on his income from the rental of several properties in Winnipeg and a farm nearby. He had an office in Winnipeg from which he conducted all transactions relating to the leasing of his dwellings, met tenants, discussed terms, prepared leases, hired and dismissed janitors, awarded contracts for repairs to his dwellings, etc. He contended that the income therefrom was "earned income" within the meaning of IWTA s. 2(1)(m) as being "derived from the carrying on of a trade, vocation or calling", and therefore was not chargeable to surtax as being "investment income".

Held, (F. Monet and W. S. Fisher), in respect of both 1946 and 1947, even if appellant's activities in leasing his dwellings etc. amounted to the carrying on of a trade (but see *Martin* v. *M.N.R.* [1948] Ex. C.R. 529) the income he received by way of rents was expressly excluded from the definition of "earned income" in s. 2(1)(m) and was therefore "investment income" under s. 2(1)(n), and so chargeable to tax.

Held, also, in respect of the 1947 taxation year, following the Board's decision in *Pitman* v. *M.N.R.* 2 T.A.B.C. 176, Tax Rev. 126, in the determination of the amount chargeable to investment income surtax appellant was entitled to a deduction for personal status of $750.

June 6, 1950 *Judgment accordingly*

Editor's Note: While the Board here was not called upon to decide that "a landowner in dealing with his own land and granting leases thereof and so receiving rents and profits is not carrying on business", in accordance with O'Connor J.'s *dicta* in *Martin* v. *MNR, supra,* it is obvious that the view thus stated by O'Connor J. is, at least, affording a basis for a line of argument. In the *Martin* case, O'Connor J. continued: "But the question here is has the appellant reached the point where landownership has passed into commercial enterprise in land", and he cites as authority for this proposition the Scottish case of *Rosyth Bldg. & Estates Co.* v. *Rogers,* 8 T.C. 11 at p. 17.

Not only do the views so expressed by O'Connor J. have reference to the British law of income tax, but, it may be pointed out, the case cited by him was in fact overruled by the House of Lords in *Fry* v. *Salisbury House Estates Ltd.* [1930] A.C. 432.

Contrary to what O'Connor J. said, therefore, profits which are referable to the ownership or occupation of land were not at that time assessed in Britain as the profits of a trade no matter how highly organized the commercial operation might be; under Schedules A and B of the British Act, a landowner or occupier is necessarily assessed by reference to the annual value of the land and not his earnings therefrom.

The Canadian Act has, of course, no schedular classification of income by reference to its scource, with a different basis of assessment for each separate classification. It is suggested, therefore, that the quoted remarks of O'Connor J. in the *Martin* case, repeated here by the Board without comment, are irrelevant to the Canadian scheme of taxation.

Blair v. M.N.R.

Depreciation allowance — Appeal from exercise of Minister's discretion

A firm of partners made substantial permanent alterations to a building in which the firm carried on business and which was owned by one of the partners. The Minister, in exercise of his discretion under IWTA s. 6(1)(n), allowed depreciation on such expenditure at 5%. The partners appealed asserting a right to a partnership deduction of 20%.

Held (*per tot. cur.*), nothing in the evidence suggested that the Minister exercised his discretion on other than reasonable and proper grounds, and the appeals must be dismissed.

June 7, 1950 *Appeals dismissed*

Georgia Hotel Co. v. M.N.R.

Interest on bonds — Disallowance of portion referable to premium

Depreciation — Building — Type of construction — Whether error of fact — Remittal to Minister for reconsideration

The company appealed from the disallowance of $3440 interest paid on the amount of a bond issue not actually received by the company but allowed as a premium to the bond purchasers. The appeal on this point was, however, abandoned at the hearing.

Appellant also appealed from the disallowance of a portion of the amount claimed as depreciation allowance on a building, and it appeared that while the allowance had been fixed by the Minister on the footing that the building was of reinforced concrete construction there was strong reason to believe, from evidence tendered at the hearing, that it was of concrete and tile construction.

Held (per Graham J. and W. S. Fisher), while the amount of depreciation allowed is in the Minister's discretion under the IWTA, it would appear that had the Minister been satisfied that the building was of concrete and tile construction depreciation would have been calculated at 2½% instead of 2%, and the matter should therefore be referred back to the Minister for reconsideration and reassessment in accordance with the actual facts.

June 10, 1950 *Judgment accordingly*

REGINA DISTRICT TAX OFFICE

By Order-in-Council 3626 of July 25, 1950, Alan Paterson is authorized, while acting as Director-Taxation in Regina, to exercise the powers and perform the duties of the Minister under sections 40(2), 49(2), 106(1)(g), 109, 114, and 115(2) of the *Income Tax Act.*

NEWFOUNDLAND DISTRICT TAX OFFICE

By Order-in-Council P.C. 3375 of July 12, 1950, A. T. Sparkes is authorized, while acting as Director-Taxation in Newfoundland, to exercise the powers and perform the duties of the Minister under sections 40(2), 49(2), 106(1)(g), 109, 114, and 115(2) of the *Income Tax Act.*

Bowyer-Boag Ltd. v. M.N.R.

Contract for installation of plumbing — Shares accepted in settlement — Sale at loss 16 years later — Whether loss deductible — Whether shares held as investment — IWTA s. 6(1)(b)

In 1928 appellant company installed plumbing and heating equipment in an apartment building owned by the MPS Co. for a contract price of $13,905, and in 1929 performed some additional work for the same company for a contract price of $2,250. The MPS Co. was in financial difficulties at the time and unable to pay cash, and eventually appellant company agreed to take in payment 110 shares of stock in the MPS Co. of a par value of $100 each, and MPS Co.'s account was marked as paid. The share certificates were delivered in 1930, and appellant company, though it continuously endeavoured to dispose of the stocks, was unable to find a purchaser, as following the stock market crash in 1929 the financial position of the MPS Co. steadily deteriorated. Appellant company did not set up a reserve for bad debts in 1928, 1929 or 1930 to cover any loss which it might incur in connection with the MPS Co.'s account though in the financial circumstances of the MPS Co. some loss on realization of the shares was virtually certain; appellant company took the stand that it could not write off a loss on the shares in advance of their realization. In 1946 the company finally disposed of the shares to its accountant for $50, the latter being the first willing purchaser found by the company. The financial position of the MPS Co. at that time was still bad. In the years since it acquired the shares appellant company had received only one dividend, amounting to $50, on the shares, and in reporting its income for 1946 claimed a deduction of $11,000 as being a loss sustained by it in respect of the shares in the process of earning its income. The Minister disallowed the deduction on the ground that the shares were substituted by appellant for the previously existing debt as an investment and that the loss incurred was a capital loss and not deductible.

Held (W. S. Fisher and F. Monet), although appellant accepted the shares as the best payment it could obtain in the circumstances and without any intention at that time of holding them as an investment, the company failed to give a satisfactory explanation for its delay over so many years in writing the debt off as bad and for reaching this decision in the year 1946; it must have been evident to appellant for many years that it would not realize $11,000 for the shares. From the evidence it may be inferred that an important influencing factor towards this decision was the fact that 1946 was the first year since 1929 in which the company had sufficient income to absorb the loss. The disposal of stock in an apartment building company for virtually nothing at a time when, with the approaching removal of rental controls, the stock would probably increase in value suggests that the company had some other object in mind, namely that it would write off its loss against the income of the first year in which it received sufficient income to absorb the loss. Further, as tax rates were much higher in 1946 than in 1928, 1929 or 1930, appellant would be receiving a considerable advantage if allowed to postpone the writing off of its bad debts for years after they became bad. In all these circumstances, therefore, it must be found that the debt in question did not become bad in 1946 and should have been written off many years earlier, at some time when the asset had a closer relationship to its original nature of a trading account receivable. In accordance with

common accounting practice in reference to accounts receivable the debt should have been written off at the time it was determined to be bad, that is shortly after receipt of the stock in 1930. Further, the shares when taken in payment of the debt became an asset in substitution for the account receivable, and while not looked on as an investment when received, cannot in 1946 be looked on as an account receivable but rather as an investment. Consequently any loss in respect of the shares after such a lengthy period must be considered a loss of capital rather than a trading loss and prohibited from deduction by IWTA s. 6(1)(b).

May 23, 1950 *Appeal dismissed*

Editor's Note: This is really a case of a trader accepting consideration other than in money in the course of trade, and it is well established in a long line of British decisions that in such cases the actual *value* of the consideration is to be entered as a trading receipt in the year in which it is taken. And a recent decision of the House of Lords deals with the very situation which was at issue here, namely, the taking of shares in the capital stock of a company for a trade debt where the shares are not realizable in cash in the year of receipt. Lord Simon states the law thus in *Gold Coast Selection Trust Ltd.* v. *Humphrey* (1948) 30 T.C. 210 at p. 240:

> "In my view the principle to be applied is the following. In cases such as this, when a trader in the course of his trade receives a new and valuable asset, not being money, as the result of sale or exchange, that asset, for the purpose of computing the annual profits or gains arising or accruing to him from his trade, should be valued as at the end of the accounting period in which it was received, even though it is neither realised nor realisable till later. The fact that it cannot be realised at once may reduce its present value, but that is no reason for treating it, for the purposes of income tax, as though it had no value until it could be realised. If the asset takes the form of fully paid shares, the valuation will take into account not only the terms of the agreement but a number of other factors, such as prospective yield, marketability, the general outlook for the type of business of the company which has allotted the shares, the result of a contemporary prospectus offering similar shares for subscription, the capital position of the company, and so forth. There may also be an element of value in the fact that the holding of the shares gives control of the company. If the asset is difficult to value, but is none the less of a money value, the best valuation possible must be made. Valuation is an art, not an exact science. Mathematical certainty is not demanded, nor indeed is it possible. . . ."

This view of the law does not turn upon any statutory provision peculiar to British tax law, and is no doubt applicable here. In this view, appellant company should have proceeded as follows. In accepting the shares of stock in 1930 in lieu of the cash price, the value of the shares, determined by the company in accordance with the above guides, should have been entered as a trading receipt in that year, and the amount of the contract price in excess of such sum would automatically be written off. The resulting position would appear in its income tax assessment for that year, and no such issues as those raised in this appeal should or could have arisen. The shares which it retained would thereafter be held as a capital asset, and any loss or gain on their subsequent disposition would be beyond the scope of the *Income Tax Act*.

Acme Co. v. M.N.R.

Remuneration of company directors — Percentage of profits earned — Discretion of Minister to disallow — IWTA s. 6(2)

In accordance with a practice it had followed since 1937, appellant company in 1946, pursuant to a resolution, paid two of its directors 20% of its profits for 1946, which amounted to $5180, as salaries for their services in

managing the affairs of the company, and deducted the equivalent amount in computing its income for tax purposes. The sum so paid was apportioned between the two directors in accordance with a private agreement between them, $3,160 to one director and $1,420 to the other. In assessing the company the sum so paid the directors less $500 paid to each was added back and charged to income tax. In a notification made by the Minister under IWTA s. 69A following receipt of a notice of objection, the Minister confirmed the assessment on the ground that the disallowance of salaries in excess of $500 each paid the directors was made in exercise of his discretion under s. 6(2) to determine that any expense is in excess of what is reasonable or normal for the business carried on by the taxpayer, and alternatively that the salaries so paid to the extent disallowed were not laid out or expended for the purpose of earning the income within the meaning of s. 6(1)(a).

Held (F. Monet and W. S. Fisher), the appeal must be allowed. Section 6(2) gives the Minister an extraordinary power and therefore must be strictly construed. Here the Minister did not in fact determine that a sum equal to 20% of the company's profits was in excess of what was reasonable and normal for the business carried on by appellant, and that is the only discretion he had to exercise under the enactment. Instead he determined the salaries of the two directors at $500 each, and this he had no authority to do. It was not the company but the directors who apportioned the gross amount between them.

June 8, 1950 *Appeal allowed*

Editor's Note: The Court did not touch upon the alternative ground advanced on behalf of the Minister.

Butler v. M.N.R.

Office or employment — Expenses incurred by employee — Not deductible — IWTA (1948) s. 6(6)

A collector employed by a railway company who had lost both legs in an accident used his own car in the performance of his duties although the railway company supplied him with street car tickets for that purpose. For the year 1948 he claimed a deduction from his salary of motor car expenses so incurred.

Held (*per tot. cur.*), the deduction fell squarely within the prohibition of IWTA s. 6(6) as enacted in 1948, and the appeal must be dismissed.

June 7, 1950 *Appeal dismissed*

THE INCOME TAX REGULATIONS

AMENDMENTS TO PARTS IX, XI, AND XVII

PROMULGATION OF PART XIX

P.C. 3002, June 20, 1950

(Canada Gazette, July 12, 1950)

HIS EXCELLENCY the Governor General in Council, on the recommendation of the Minister of National Revenue and by virtue of the powers conferred by s. 106 of the *Income Tax Act*, is pleased to amend the Income Tax Regulations made and established by Order in Council P.C. 6471 of 22nd December 1949, as amended, and the said Regulations are hereby further

amended effective the first day of February, 1950, by revoking subsec. (1) of s. 900 thereof [[*1949*] *Tax Rev. 109*], and by substituting therefor the following new subsection (1):

Sec. 900(1)

(1) [The Assistant Deputy Minister of National Revenue for Taxation][1] may exercise all the powers and perform all the duties of the Minister under the Act.

[1] The clause in square brackets is substituted for the words *"The Co-ordinator and Chairman of the Executive of the Taxation Division of the Department of National Revenue"*.

* * *

His Excellency in Council is further pleased, hereby, to amend the said Regulations as follows, applicable to the 1949 and subsequent taxation years:

1. By revoking para. (*g*) of subsec. (1) of s. 1102 [[*1950*] *Tax Rev. 4*] thereof, and by substituting therefor the following new para. (*g*):

Sec. 1102(1)(g)

[1](*g*) in respect of which an allowance is claimed and permitted in accordance with Part XVII of these Regs.

[1] This paragraph formerly was as follows: *"that was acquired for the purpose of gaining or producing income from farming or fishing."*

* * *

2. By adding thereto immediately after s. 1703 [[*1950*] *Tax Rev. 49*] thereof the following new s. 1704:

Sec. 1704

1704. This Part shall not apply where a taxpayer has claimed an allowance computed under Part XI in computing his income from farming or fishing for the taxation year or any previous taxation year.

* * *

3. By adding thereto immediately after Part XVIII thereof the following new Part XIX:

PART XIX

MINES EXEMPT UNDER SECTION 74 OF THE ACT

Sec. 1900

1900. (1) For the purpose of subsec. (1) of s. 74 of the Act, the following conditions are hereby prescribed:

(*a*) the corporation shall maintain separate accounting records in respect of the mine

(i) for the period beginning with the commencement of operation of the mine by the corporation and ending with the day before the day on which the mine came into production, and

(ii) for each taxation year of the corporation which includes a part of the 36 months beginning with the day on which the mine came into production,

(*b*) if the operation of the mine was the only business carried on by the corporation on the day before the day on which the mine came into production, the corporation shall end its taxation year and close its books of account as of that day,

(*c*) if paragraph (*b*) does not apply, the corporation shall close its accounting records in respect of the mine on the day that is 36 months after the day on which the mine came into production, and

(*d*) the corporation shall file a return in duplicate in prescribed form with the Minister.

PARTS XX AND XXI PROMULGATED

P.C. 3374, July 12, 1950

HIS EXCELLENCY the Governor in Council, on the recommendation of the Minister of National Revenue and by virtue of the powers conferred by s. 106 of the *Income Tax Act*, is pleased to amend the Income Tax Regulations made and established by Order in Council P.C. 6471 of 22nd December 1949, as amended, and the said Regulations are hereby further amended by adding thereto, immediately after Part XIX thereof, the annexed Parts XX and XXI, Part XX to be applicable to amounts paid or credited after 1948.

Canada Gazette, July 26, 1950

PART XX

Surpluses for the Purposes of Non-Resident Tax

Sec. 2000

2000. For the purpose of subsec. (1) of s. 96 of the Act, the surplus of a non-resident-owned investment corporation for a taxation year is the amount by which the income of the corporation for the year exceeds the aggregate of

(*a*) each expense incurred or disbursement made by the corporation during the year that was not allowed as a deduction in computing income for the year under Part I of the Act other than

(i) an expense incurred or disbursement made in respect of the acquisition of property (including goodwill) or the repayment of loans or capital, and

(ii) income taxes paid or payable to His Majesty in the right of Canada, and

(*b*) the amount by which the aggregate of losses sustained by the corporation in each taxation year subsequent to its 1932 taxation year exceeds the aggregate of

(i) the amounts in respect of such losses that were allowed as deductions in computing taxable income for years when the corporation was taxed under subsec. (4) of s. 9 of the *Income War Tax Act*, and

(ii) the amounts in respect of such losses that were deductible in computing the surplus for prior taxation years.

Sec. 2001

2001. For the purpose of subsec. (3) of s. 97 of the Act, the surplus of a corporation as of any time is the amount by which the aggregate of the incomes of the corporation for the taxation years subsequent to its 1932 taxation year and ending with the specified taxation year exceeds the aggregate of

(*a*) each loss sustained by the corporation in any of those taxation years,

(*b*) each expense incurred or disbursement made by the corporation during those years that was not allowed as a deduction in computing income for the year under Part I of the Act other than

(i) an expense incurred or disbursement made in respect of the acquisition of property (including goodwill) or the repayment of loans or capital, and

(ii) income taxes paid or payable to His Majesty in the right of Canada,

(*c*) an amount equal to 100/5 of all taxes paid to His Majesty in the right of Canada on income of the corporation under Part I of

the Act in respect of any of those taxation years ending prior to April 30, 1941,

(*d*) an amount equal to 100/5 of all taxes paid to His Majesty in the right of Canada under Part II of the Act in respect of dividends paid or amounts deemed to be paid as dividends in any of those taxation years prior to April 30, 1941,

(*e*) an amount equal to 100/15 of all taxes paid to His Majesty in the right of Canada on income of the corporation under Part I of the Act in respect of any of those taxation years ending after April 29, 1941, and

(*f*) an amount equal to 100/15 of all taxes paid to His Majesty in the right of Canada under Part II of the Act in respect of dividends paid or amounts deemed to be paid as dividends subsequent to April 29, 1941.

Sec. 2002

2002. Where a corporation was resident in Newfoundland on the expiration of March 31, 1949 and was not resident in Canada in 1949 prior to that time, taxation years prior to that time shall not be included in computing the surplus for the purpose of secs. 2000 and 2001.

Sec. 2003

2003. For the purpose of this Part "loss" for a taxation year means a loss computed by applying the provisions of the Act respecting computation of the corporation's income *mutatis mutandis.*

PART XXI

Election to Pay Tax on Undistributed Income

Sec. 2100

2100. (1) Election by a private company to pay tax under subsection (1) of s. 95A of the Act shall be made by filing with the Minister the following documents in duplicate:

(*a*) the form prescribed by the Minister;

(*b*) a certified copy of the resolution of the Directors of the corporation authorizing the election to be made;

(*c*) schedules showing the corporation's computation of undistributed income and tax-paid undistributed income; and

(*d*) where the corporation has more than 75 shareholders, an explanation of how the corporation qualifies as a private company.

(2) Election by a private company to pay tax under subsec. (2) of s. 95A of the Act shall be made by filing with the Minister the following documents in duplicate:

(*a*) the form prescribed by the Minister;

(*b*) a certified copy of the resolution of the Directors of the corporation authorizing the election to be made; and

(*c*) where the corporation has more than 75 shareholders, an explanation of how the corporation qualifies as a private company.

DEPARTMENT OF NATIONAL REVENUE
TAXATION DIVISION
INFORMATION BULLETIN NO. 1

June 23, 1950

REPORTING OF AMOUNTS PAID OR CREDITED TO RESIDENTS OF CANADA

The information returns to be used in reporting amounts paid or credited to *residents* of Canada, as required by the *Income Tax Act* and Regulations, are as follows:

T3 - Estates or Trusts
"Information Return and Income Tax Return"

This return will be completed by persons acting in a fiduciary capacity in respect of estates or trusts. One copy of the Summary and two copies of the Supplementary are required to be filed with the District Taxation Office within 90 days from the end of the taxation year of the estate or trust.

T4 - "Return of Remuneration Paid"

This return will be completed by every person who paid salary or wages or other remuneration, director's fees, other fees, commissions or other amounts for services, superannuation or pension payments, retiring allowance, annuity payments or lump sum (retirement, death and withdrawal) payments. One copy (Summary and Supplementary) is required to be filed annually with the District Taxation Office not later than the last day of February.

T5 - "Return of Investment Income"

This return will be completed by every person in Canada making payments, whether as payor, nominee or agent, in respect of interest, dividends, patronage payments or royalties. One copy (Summary and Supplementary) is required to be filed annually with the District Taxation Office not later than the last day of February.

T600 - "Ownership Certificate"

One copy of this form will be completed by or on behalf of a Canadian resident before negotiating a bearer coupon or warrant representing either interest or dividends payable by any debtor *or* cheque representing dividends or interest payable by a non-resident debtor. The cashing agent will forward forms **T600** to the District Taxation Office not later than the 15th day of the month following the month of negotiation.

SPECIAL INSTRUCTIONS RELATED TO INVESTMENT INCOME TO BE REPORTED ON THE T5 RETURN

Investment income has been reported in the past on separate returns prescribed for each particular type of such income.

Henceforth the investment income to be reported on a T5 return consists of

1. Deposit interest, (including interest paid or credited by stock brokers or investment dealers), registered bond or debenture interest, and bearer interest not already reported in the name of the beneficial owner on form **T600**.
2. Dividends paid in cash or kind. Dividends will also include the taxable portion of amounts deemed to be a dividend in the event of winding-up, discontinuance, or reorganization of the business; redemption, or conversion of common shares; or capitalizing of undistributed income.
3. Patronage payments made to customers in respect of allocation in proportion to patronage, including payments made in cash or kind, by certificate of indebtedness, or shares and whether by way of set-off, assignment or in any other manner.

4. Royalty payments in respect of the use of a work or invention or the right to take natural resources.

These payments shall be reported if made directly by a payor or disbursing agent *or* indirectly by a nominee or agent to a third person.

Only amounts, the aggregate of which exceeds $100 annually, shall be reported. This reporting limitation may vary annually and shall be as prescribed on the return.

The payor may file separate supplementaries for each type of payment.

Additional Information Applicable to Nominees Only

The name of the nominee will be shown on the Supplementary as the payor, and the income will be reported on each slip in the appropriate boxes.

Gross interest will be reported and must not be reduced by carrying or similar charges.

The gross income received from a foreign debtor and the tax withheld by a foreign government shall, for the purposes of reporting, be converted to Canadian currency.

When a nominee does not wish to provide individual forms T600, the cashing agent may accept an ownership certificate on which the nominee endorses a certification undertaking to report the information annually on form T5.

Branches of Canadian businesses located outside of Canada are required to file in accordance with the instructions applicable to branches located in Canada.

PAYMENTS TO NON-RESIDENTS

The instructions for reporting of amounts paid or credited to non-residents of Canada and for the remittance of non-resident tax withheld are contained in Information Bulletin No. 2, *post.*

Canada Gazette, July 12, 1950

V. W. SCULLY
Deputy Minister (Taxation)

INFORMATION BULLETIN NO. 2

June 23, 1950

REPORTING AMOUNTS PAID OR CREDITED TO, AND REMITTANCE OF TAX WITHHELD FROM, NON-RESIDENTS OF CANADA

This bulletin outlines the procedure for reporting amounts paid or credited to, and for the remittance of tax withheld from, *non-residents* of Canada as required by the *Income Tax Act* and Regulations.

The bulletin consists of three parts:

PART I - Remuneration Paid and Investment Income
PART II - Estate or Trust Income
PART III - Refunds.

PART I

REMUNERATION PAID TO NON-RESIDENTS

The forms to be used in respect of this type of payment are:

T4 - "Return of Remuneration Paid"
TD7A - "Tax Deduction Remittance Form"
UST 456 - "Return of Amounts Paid or Credited to Persons in the United States of America".

Remuneration paid includes salaries, wages or other remuneration, director's fees, other fees, commissions and other amounts for services; superannuation or pension payments, retiring allowance, annuity payments, and lump sum (retirement, death and withdrawal) payments.

Remuneration paid to a non-resident of

Canada will be reported on the T4 return (Summary and Supplementary) in accordance with the instructions relating to similar payments made to Canadian residents. In addition, all remuneration paid to addressees in the United States of America will be reported annually on a UST 456 return (Summary and Supplementary). This return, together with the T4 return, will be filed with the District Taxation Office not later than the last day of February.

Tax will be withheld from payments made to non-residents for services rendered in Canada in accordance with instructions contained in the current table of "Income Tax Deductions at Source".

The Canadian tax withheld will be remitted, together with form **TD7A**, to the District Taxation Office not later than the 7th day of the month following the month of payment.

Investment Income Paid to Non-Residents

The *Income Tax Act*, Part II, sections 96 to 99, inclusive, specifies the rates for non-resident tax and the conditions under which that tax is exigible.

The following are the types of payments included under investment income. These are divided into specific groups according to the similarity in the method of reporting. The forms to be used are shown in each group.

(a) Negotiation of Dividend Warrants of Canadian Securities Payable in any Currency or Interest Coupons Payable Only in Canadian Currency

The forms to be used in respect of these types of payments are:

T601 - **"Ownership Certificate"**

T603 - **"Non-Resident Tax Remittance Form"**

Form **T601** will be completed by or on behalf of the non-resident except where tax is not required to be withheld. The requirements for the withholding of tax are outlined on form **T601**.

The cashing agent will forward forms **T601**, together with form **T603** and the tax withheld, to the District Taxation Office not later than the 15th day of the month following the month of negotiation.

(b) Registered Bond or Deposit Interest, Dividends Payable by Cheque, Patronage Payments, Royalties and Payments by Nominees

The forms to be used in respect of these types of payments are:

T603 - **"Non-Resident Tax Remittance Form"**

UST 456 - **"Return of Amounts Paid or Credited to Persons in the United States of America"**

The tax deducted from payments to addressees in the United States will be reported as a bulk sum on form **T603**, with the notation "United States Residents". Payments to other non-residents will be reported in detail on form **T603** showing name and country of non-resident, kind of income, and tax withheld.

The tax withheld will be remitted, together with one copy of form **T603**, to the District Taxation Office not later than the 15th day of the month following the month of payment.

The details of payments to addressees in the United States of America will be reported annually on a **UST 456** return. This return will be filed with the District Taxation Office, together with the related "Return of Investment Income" for Canadian residents, not later than the last day of February.

(c) Interest on Mortgages and Promissory Notes, Alimony, Motion Picture Film Payments, and Rents (other than Real Estate)

The forms to be used in respect of these types of payments are:

T603 - **"Non-Resident Tax Remittance Form"**

UST 456 - **"Return of Amounts Paid or Credited to Persons in the United States of America".**

All payments will be reported in detail

on form T603 showing name and country of non-resident, kind of income, gross payment, and tax withheld.

The tax withheld will be remitted, together with one copy of form T603, to the District Taxation Office not later than the 15th day of the month following the month of payment.

The details of payments to addressees in the United States of America will be reported annually on a UST 456 return. This return will be filed with the District Taxation Office not later than the last day of February.

(d) Rents from Real Estate, Including Crop Shares

The forms to be used in respect of this type of payment are:

T700 - **"Non-Resident Tax Remittance Form" (Real Estate Rents)**

T700A - **"Undertaking to File Income Tax Return by Non-Resident Real Estate Owner"**

UST 456 - **"Return of Amounts Paid or Credited to Persons in the United States of America".**

All payments will be reported in detail on a separate form T700 for each non-resident. The address or location of property, period covered, amount of rent paid, credited, or available, and tax withheld will be reported on this form.

The tax withheld will be remitted to the District Taxation Office together with one copy of form T700 not later than the 15th day of the month following the month of payment.

The tax will be withheld from gross rents unless the non-resident has filed with the District Taxation Office, form T700A, through his Canadian agent, including tenant acting as agent.

Where form T700A has been filed, the agent may elect to deduct tax from amounts available to the non-resident instead of from gross rents.

Where payments of rent are made to addressees in the United States of America, the gross amounts of such payments will be reported annually on a UST 456 return. This return will be filed with the District Taxation Office not later than the last day of February.

PART II

Estate or Trust Income Paid to Non-Residents

The forms to be used in respect of this type of income are:

T3 - **Estates or Trusts - "Information Return and Income Tax Return"**

T3C - **"Allocation of Non-Resident Tax to Estates or Trusts"**

T603 - **"Non-Resident Tax Remittance Form"**

UST 456 - **"Return of Amounts Paid or Credited to Persons in the United States of America".**

The details of amounts paid or credited to non-resident beneficiaries, as determined in accordance with the T3 return of the estate or trust, will be reported on the supplementary portion of the T3 return.

The T3 return (Summary and Supplementary) is required to be filed annually within 90 days from the end of the taxation year of the estate or trust.

Where the income of a non-resident beneficiary is increased as a result of the assessment of the T3 return, an assessment notice, covering the increase in the non-resident tax, will be issued. Payment of the amount due should be made forthwith to the District Taxation Office and reference made to the assessment notice.

Amounts paid or credited to beneficiaries in the United States of America will be reported annually, on one UST 456 return, for all estates or trusts under the administration of a trustee, executor or administrator. This return will be filed with the District Taxation Office not later than the last day of February.

An individual, acting in the capacity of

trustee, executor or administrator for estates or trusts, will remit non-resident tax withheld, together with form T603, to the District Taxation Office not later than the 15th day of the month following the month of payment. Form T603 is to show, by estate or trust, the complete details with respect to each non-resident beneficiary. An individual trustee, executor or administrator of several estates or trusts with non-resident beneficiaries, may obtain consent of the District Taxation Office to follow the procedure required of a corporation acting as trustee, executor or administrator.

A corporation, acting in the capacity of a trustee, executor or administrator for estates or trusts, will remit, in bulk, the non-resident tax withheld, together with form T603, to the District Taxation Office, not later than the 15th day of the month following the month of payment. Form T603 will show an analysis of the remittance by fiscal years to which such remittance applies.

A statement will be prepared on form T3C and forwarded to the District Taxation Office within 90 days after each quarter ending on March 31, June 30, September 30 and December 31 of the calendar year. This statement will show the amount of non-resident tax payable with respect to each estate or trust whose fiscal period ended in the quarter of the calendar year for which it is provided. For example, estates or trusts whose fiscal period ended in the last quarter of a calendar year must be reported on a statement to be forwarded by 31st March of the following year.

The taxes remitted as a bulk sum will be transferred, progressively, in each quarterly statement, to the credit of the individual estate or trust. The method of accomplishing this is set out clearly on form T3C.

PART III

Refunds

An application for refund of tax deducted from non-residents shall be made to the District Taxation Office within two years from the end of the calendar year in which the tax was paid.

To obtain a refund in the case of:

remuneration of real estate rental income, an income tax return, T1 (Individual) or T2 (Corporation) is required to be completed and filed;

estate or trust income, no application is required as the refund will be made following assessment of the T3 return and issuance of the assessment notice;

investment income, form T603R "Application for Refund of Non-Resident Tax" is required to be completed and filed.

PAYMENTS TO RESIDENTS OF CANADA

The instructions for reporting of amounts paid or credited to residents of Canada are contained in Information Bulletin No. 1, *ante.*

V. W. Scully

Canada Gazette, July 12, 1950 *Deputy Minister (Taxation)*

PROCLAMATION OF AMENDMENTS

By proclamation of His Excellency the Governor-General, dated June 27, 1950, section 23(1) and section 44(1) of the *Income Tax Amendment Act,* 1949 (2nd Sess.), c. 25, came into force and have effect upon, from and after July 1, 1950.

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